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UNITED STATES DISTRICT COURT

SOUTHERN DISTRICT OF CALIFORNIA

HCL PARTNERS LIMITED PARTNERSHIP, on behalf of itself and all others similarly situated, Plaintiff, v. LEAP WIRELESS INTERNATIONAL, INC., S. DOUGLAS HUTCHESON, AMIN I. KHALIFA, GRANT A. BURTON, MICHAEL B. TARGOFF, JOHN D. HARKEY, ROBERT V. LaPENTA, AND PRICEWATERHOUSECOOPERS, LLP, Defendants.	CASE NO.: 07-CV-2245-BTM **MEMORANDUM OF POINTS AND AUTHORITIES IN SUPPORT OF INDIVIDUAL DEFENDANTS' MOTION TO DISMISS PLAINTIFFS' CONSOLIDATED CLASS ACTION COMPLAINT** Date: November 21, 2008 Time: 11:00 a.m. Dept: 15 Before: Hon. Barry Moskowitz
KENT CARMICHAEL, Individually and On Behalf of All Others Similarly Situated, Plaintiff, v. LEAP WIRELESS INTERNATIONAL, INC., S. DOUGLAS HUTCHESON, AMIN I. KHALIFA, GRANT A. BURTON, MICHAEL B. TARGOFF, JOHN D. HARKEY, ROBERT V. LaPENTA, AND PRICEWATERHOUSECOOPERS, LLP, Defendants.	CASE NO.: 08-CV-0128-BTM

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Defendants S. Douglas Hutcheson, Amin I. Khalifa, Grant A. Burton, Michael B. Targoff, John D. Harkey, Jr., and Robert V. LaPenta (the "Individual Defendants") respectfully submit this Memorandum of Points and Authorities in Support of the Individual Defendants' Motion to Dismiss Plaintiff's Consolidated Class Action Complaint (the "Complaint"). The Individual Defendants also join in the Motion to Dismiss filed by Leap Wireless International, Inc. ("Leap" or the "Company").

MEMORANDUM OF POINTS AND AUTHORITIES

INTRODUCTION

On November 9, 2007, Leap announced that it would be restating its financial statements for the years 2004-2006 and the first two quarters of 2007. Despite the fact that the Company explained that an internal review had concluded that the restatements were not attributable to any misconduct by Company employees, several securities class action complaints alleging fraud were filed shortly thereafter. Two of those complaints subsequently were voluntarily dismissed, and the remaining two complaints were consolidated in the instant action. Based on little more than the fact that a financial restatement occurred, Plaintiff's consolidated complaint attempts – unsuccessfully – to convert mere accounting errors into securities fraud.

Plaintiff's Complaint alleges that the defendants violated Section 10(b) of the Securities Exchange Act of 1934 (the "Exchange Act") by making misrepresentations and omissions throughout the Class Period regarding the Company's financial results, financial condition, and internal controls. Because Plaintiff asserts claims under the Exchange Act, Plaintiff's Complaint is subject to the heightened pleading requirements of the Private Securities Litigation Reform Act (the "Reform Act"). To withstand these rigorous pleading requirements, Plaintiff must plead particularized facts giving rise to a strong inference that the defendants acted with scienter – an essential element of a Section 10(b) claim. Thus, Plaintiff must plead particularized facts demonstrating that *each* of the Individual Defendants knowingly, or with deliberate recklessness, disseminated false financial or other statements during the Class Period. Not only does Plaintiff fail to plead any such facts, but also, the very documents cited in Plaintiff's Complaint give rise to competing and compelling inferences of non-culpable conduct. Indeed, the Company's disclosure that the errors were discovered as a result of an internal review suggests that the defendants sought to uncover – rather than conceal – such issues.

Unable to plead facts demonstrating that any of the Individual Defendants intentionally or recklessly disseminated false statements, Plaintiff attempts to bolster the Complaint's inadequate scienter allegations with allegations of insider trading. Specifically, Plaintiff alleges that the Individual Defendants were "motivated" to engage in the alleged fraudulent scheme to profit from insider stock sales. Plaintiff's "motive and opportunity" allegations, however, suffer from numerous deficiencies. *First*, several of the individuals named as defendants in the Complaint did not sell *any* stock during the Class Period. *Second*, Plaintiff fails to plead facts – as Plaintiff must – demonstrating that the stock sales by the Individual Defendants who actually did sell stock during the Class Period were unusual or suspicious. *Third*, over ninety percent of the sales alleged in the Complaint were made by *non-defendants*, and are thus irrelevant to Plaintiff's claims. Plaintiff's stock sale allegations thus fail to provide the missing inference of scienter.

In sum, Plaintiff fails to plead particularized facts giving rise to a strong inference of scienter as to *any* of the Individual Defendants. Plaintiff's Section 10(b) claim should therefore be dismissed. Because Plaintiff's Section 20(a) claim for control person liability rises and falls with the Section 10(b) claim, Plaintiff's Section 20(a) claim should also be dismissed.

BACKGROUND

A. The Individual Defendants

The Individual Defendants include six current and former officers and directors of Leap.

The "Management Defendants"

Plaintiff alleges that the individuals identified as "Management Defendants" served in the following positions at Leap during the Class Period: S. Douglas Hutcheson served as President and Chief Executive Officer ("CEO") (Complaint ¶ 21); Amin I. Khalifa served as Chief

Financial Officer ("CFO") and Executive Vice President (*id.* ¶ 24);[1] and Grant A. Burton served as Vice President, Chief Accounting Officer and Controller (*id.* ¶ 23).

The Audit Committee Defendants

The "Audit Committee Defendants" identified in Plaintiff's Complaint are three outside directors: Michael B. Targoff, John D. Harkey, Jr., and Robert V. LaPenta. Complaint ¶¶ 26-28. Plaintiff alleges that Mr. Targoff has served as a member of the Board of Directors of Leap since 1998 and also served as the Chairman of the Audit Committee. *Id.* ¶ 26. Plaintiff alleges that Mr. Harkey has served as a director of Leap since March 2005 and also served as a member of the Audit Committee. *Id.* ¶ 27. Plaintiff alleges that Mr. LaPenta has served as a director since March 2005 and also served as a member of the Audit Committee. *Id.* ¶ 28.

B. The Restatement

On November 9, 2007, Leap announced that it would restate its financial statements for fiscal years 2004-2006 and for the first two quarters of 2007. Complaint ¶¶ 1, 138-39. The November 9, 2007 press release stated that the purpose of the restatement was to correct errors in previously reported service revenues, equipment revenues, and operating expenses. *Id.* ¶ 139. The press release further stated that "[t]he restatements are the result of an internal review of the Company's service revenue activity and forecasting process that was initiated by management in September 2007 and are not attributable to any misconduct by Company employees." *Id.*

On December 26, 2007, the Company filed with the Securities and Exchange Commission ("SEC") an amended Form 10-K/A for the fiscal year ended December 31, 2006, which incorporated the restated financial information. Complaint ¶ 148. The Form 10-K/A explained that the financial statements had been "restated to correct errors relating to (i) the timing of recognition of certain service revenues prior to or subsequent to the period in which they were earned, (ii) the recognition of service revenues for certain customers that voluntarily disconnected service and (iii) the classification of certain components of service revenues, equipment revenues and operating expenses." *Id.*

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[1] Mr. Khalifa resigned from the Company prior to the end of the Class Period. *See* Declaration of Diane M. Walters in Support of Individual Defendants' Motion to Dismiss ("Walters Decl."), Exhibit ("Ex.") A.

C. Procedural History

Between November 27, 2007 and January 23, 2008, four securities class action complaints were filed against Leap and several of its current and former officers and directors.[2] Two of the class action complaints subsequently were voluntarily dismissed. On May 23, 2008, the Court entered an order consolidating the remaining two actions and appointing The New Jersey Carpenters Pension and Benefits Funds ("Plaintiff") as Lead Plaintiff. Plaintiff filed the instant Complaint on July 7, 2008.

D. Summary of Allegations

Plaintiff purports to bring the Complaint on behalf of individuals who purchased or otherwise acquired Leap securities between August 3, 2006 and November 9, 2007 (the "Class Period"). Complaint ¶ 1. Plaintiff asserts two causes of action for alleged violations of Sections 10(b) and 20(a) of the Exchange Act. *Id.* In the Complaint, Plaintiff generally alleges that the defendants made misrepresentations and omissions regarding the Company's financial condition and internal controls throughout the Class Period as part of a "plan, scheme and course of conduct" designed to deceive the investing public and to inflate the price of Leap stock. *Id.* ¶¶ 2, 203-212. Plaintiff further alleges that the Individual Defendants are liable pursuant to Section 20(a) "[b]y virtue of their positions as controlling persons." *Id.* ¶ 216.

ARGUMENT

I. APPLICABLE LEGAL STANDARDS

Section 10(b) of the Exchange Act prohibits "(1) the 'use or employ[ment] . . . of any . . . deceptive device,' (2) 'in connection with the purchase or sale of any security,' and (3) 'in contravention of' Securities and Exchange Commission 'rules and regulations.'" *See Dura Pharm., Inc. v. Broudo,* 544 U.S. 336, 341-42 (2005) (alterations in original) (citing 15 U.S.C. § 78j(b)). SEC Rule 10b-5 prohibits, among other conduct, "any device, scheme, or artifice to defraud," material misrepresentations and omissions, or "any act, practice, or course of business which operates . . . as a fraud or deceit upon any person." 17 C.F.R. § 240.10b-5. Claims asserted under Section 10(b)/Rule 10b-5 must satisfy both the pleading requirements of Federal Rule of Civil Procedure 9(b) and the heightened pleading requirements of the Reform Act.

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[2] A shareholder derivative action also was filed and is currently pending before this Court. *See Graham v. Hutcheson, et al.*, Case No. 08-cv-0246 (S.D. Cal. Feb. 7, 2008).

Enacted by Congress in 1995 as "a check against abusive litigation in private securities fraud actions," the Reform Act imposes "exacting pleading requirements" and "requires plaintiffs to state with particularity both the facts constituting the alleged violation, and the facts evidencing scienter, *i.e.*, the defendant's intention 'to deceive, manipulate, or defraud.'" *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 127 S. Ct. 2499, 2501 (2007) (citation omitted); *see also* 15 U.S.C. § 78u-4(b). As the Ninth Circuit recently recognized, "[d]ue in large part to the enactment of the [Reform Act] . . . plaintiffs in private securities fraud class actions face formidable pleading requirements to properly state a claim and avoid dismissal under Fed. R. Civ. P. 12(b)(6)." *Metzler Inv. GMBH v. Corinthian Colls., Inc.*, 534 F.3d 1068, 2008 WL 3905427, at *1 (9th Cir. Aug. 26, 2008) (affirming dismissal of securities class action complaint). Indeed, the Reform Act expressly provides that complaints that do not satisfy these rigorous pleading requirements "shall" be dismissed. 15 U.S.C. § 78u-4(b)(3)(A).

Among the "formidable" requirements imposed by the Reform Act is the requirement that plaintiffs plead sufficient facts to "raise a 'strong inference' of scienter – *i.e.*, a strong inference that the defendant acted with an intent to deceive, manipulate or defraud." *Metzler*, 2008 WL 3905427, at *8 (citations omitted). In the Ninth Circuit, the requisite mental state for a Section 10(b) claim is "deliberately reckless or conscious misconduct." *In re Silicon Graphics Inc. Sec. Litig.*, 183 F.3d 970, 974 (9th Cir. 1999).

To "qualify" as a "strong inference" of scienter, the "inference of scienter must be more than merely 'reasonable' or 'permissible' – it must be cogent and compelling, thus strong in light of other explanations." *Tellabs*, 127 S. Ct. at 2510. In applying this standard, "'the court must consider *all* reasonable inferences to be drawn from the allegations, including inferences unfavorable to the plaintiffs.'" *Metzler*, 2008 WL 3905427, at *8 (citation omitted). An evaluation of Plaintiff's conclusory scienter allegations under this standard reveals that the Complaint falls far short of satisfying the Reform Act's "formidable" pleading requirements.

II. PLAINTIFF'S COMPLAINT FAILS TO PLEAD PARTICULARIZED FACTS GIVING RISE TO A STRONG INFERENCE OF SCIENTER AS TO ANY INDIVIDUAL DEFENDANT

To withstand the stringent pleading requirements of the Reform Act, Plaintiff must "state with particularity facts giving rise to a strong inference that *the defendant* acted with the required state of mind." 15 U.S.C. § 78u-4(b)(2) (emphasis added). Thus, Plaintiff must plead with particularity facts giving rise to a strong inference of scienter as to *each* defendant. *Id.*; *see also In re VeriSign, Inc., Derivative Litig.*, 531 F. Supp. 2d 1173, 1207 (N.D. Cal. 2007) ("It is not sufficient under the PSLRA to allege scienter against defendants as a group."). Plaintiff's Complaint fails to plead the requisite particularized facts as to any of the Individual Defendants.

A. The Restatement Does Not Give Rise to a Strong Inference of Scienter

The mere fact that errors were made that led to a financial restatement does not give rise to a strong inference of scienter. *See DSAM Global Value Fund v. Altris Software, Inc.*, 288 F.3d 385, 390 (9th Cir. 2002) ("[T]he mere publication of inaccurate accounting figures, or a failure to follow GAAP, without more, does not establish scienter."); *VeriSign*, 531 F. Supp. 2d at 1207 ("[T]he mere fact that a corporation restates its financial statements does not give rise to a strong inference that any individual defendant acted with intent to defraud."). Nor does the existence of weaknesses in internal controls, without more, give rise to a strong inference of scienter. To the contrary, "[p]resumably every company that issues a financial restatement because of GAAP errors will cite as the reason a lack of effective internal controls." *In re Hypercom Corp. Sec. Litig.*, No. CV-05-0455-PHX, 2006 WL 1836181, at *9, 11 (D. Ariz. July 5, 2006) (dismissing complaint with prejudice for failure to allege scienter following disclosure of internal control weaknesses leading to restatement); *see also In re Hansen Natural Corp. Sec. Litig.*, 527 F. Supp. 2d 1142, 1158 (C.D. Cal. 2007) ("'[a]llegations that Defendants had deficient internal controls during the class period does not create a strong inference that Defendants knowingly [made] false or misleading statements'") (citation omitted).

Rather, to plead facts sufficient to give rise to a strong inference of scienter in connection with the restatement, Plaintiff must plead detailed facts showing that the Individual Defendants intentionally disseminated false statements or were deliberately reckless in connection with their dissemination. *See In re Vantive Corp. Sec. Litig.*, 283 F.3d 1079, 1090-91 (9th Cir. 2002) (plaintiffs must "allege specific contemporaneous conditions known to the defendants that would strongly suggest that the defendants understood" at the time the financials were issued that the company's accounting was improper); *see also In re Int'l Rectifier Corp. Sec. Litig.*, No. 07-02544, 2008 U.S. Dist. LEXIS 44872, at *41 (C.D. Cal. May 23, 2008) ("Such violations, even significant ones or ones requiring large or multiple restatements, must be augmented by other specific allegations that defendants possessed the requisite mental state.") (footnote omitted). Plaintiff fails to plead any such facts.

B. The Complaint Fails to Plead Particularized Facts Demonstrating Each Defendant's Awareness of Alleged Accounting and Internal Control Issues

As demonstrated in detail in the Company's Motion to Dismiss, Plaintiff fails to plead particularized facts demonstrating that any Individual Defendant was aware of, much less actively concealed, inaccuracies in the Company's financial or other public statements. *See* Leap Motion to Dismiss at 9-12, 15-25. In particular, Plaintiff's Complaint fails to provide any contemporaneous facts demonstrating that any of the Individual Defendants had knowledge of inaccuracies in the challenged statements at the time they were issued. *See, e.g., Alaska Elec. Pension Fund v. Adecco S.A.*, 434 F. Supp. 2d 815, 823 (S.D. Cal. 2006) ("Plaintiffs must allege facts showing Defendants knew, when preparing the year-end financials, . . . that the receivables should have been written off, but they fraudulently chose to delay the write-down."), *aff'd*, 256 Fed. Appx. 74 (9th Cir. 2007). Indeed, the Complaint is devoid of particularized allegations detailing how, when or where Messrs. Hutcheson, Khalifa, Burton, Targoff, Harkey, or LaPenta learned of any of the accounting or internal control issues that were the subject of the restatement. *See VeriSign*, 531 F. Supp. 2d at 1207 (rejecting conclusory assertions of scienter where the complaint failed to plead "a single fact showing what each defendant knew, when he/she knew it, or how he/she acquired that knowledge"). Plaintiff's failure to plead such details is fatal to its Section 10(b) claim.

Nor do Plaintiff's "Confidential Witness" allegations cure these pleading deficiencies. As demonstrated in the Company's Motion to Dismiss, Plaintiff's "Confidential Witness" ("CW") allegations fail to give rise to a strong inference of scienter on the part of any defendant, including the Management Defendants singled out by Plaintiff. *See* Leap Motion to Dismiss at 3, 9-12, 21-24. The weaknesses in these allegations are particularly evident with respect to the allegations regarding the Audit Committee Defendants. For example, Plaintiff alleges that the Audit Committee "knew or was deliberately reckless as to the falsity" of the Company's financial statements and statements regarding internal controls because the Audit Committee was "apprised" of: (i) the Company's retention of consultants to address internal control issues, (ii) "improper revenue recognition practices as reflected in Minutes Reports and reports of failed reconciliation of Billing System 'revenue' with cash receipts," (iii) "fundamental internal control deficiencies in the operations of the Billing System and its integration, or lack of integration, with the Provisioning System," and (iv) "the assessments uploaded to the Oracle Accounting Database by the outside compliance and auditing consultants disclosing improper revenue recognition and fundamental internal controls weaknesses and deficiencies." Complaint ¶ 31. Yet, a review of the "Percipient Witnesses" section of the Complaint (*id.* ¶¶ 44-49) reveals that not one of the CWs is alleged to have had any interaction with any of the Audit Committee members. Nor do any of the witnesses claim to have knowledge regarding what documents or information the Audit Committee may have reviewed during the Class Period. Thus, the CWs are in no position to speak as to what any of the Audit Committee members did or did not know during the Class Period, and the CW allegations fail to provide any factual support for Plaintiff's contention that Messrs. Harkey, LaPenta and Targoff had been "apprised of" of various deficiencies.

1. Plaintiff's Allegations Regarding Signatures on SEC Filings Do Not Give Rise to a Strong Inference of Scienter.

Plaintiff also attempts to create an inference of scienter based on the Individual Defendants' signatures on SEC filings during the relevant period. Specifically, Plaintiff alleges that each of the Individual Defendants knowingly disseminated false statements in the 2006 SEC Form 10-K and that each of the Individual Defendants signed that document. Complaint ¶¶ 111, 114. Additionally, Plaintiff alleges that Messrs. Hutcheson and Khalifa signed certain SEC Forms 10-Q during the Class Period. *Id.* ¶¶ 81, 89, 91, 126. Plaintiff fails, however, to plead particularized, contemporaneous facts demonstrating that any of the Individual Defendants was aware of the alleged accounting errors or internal control issues when these documents were filed. Plaintiff's conclusory "signature" allegations thus fail to give rise to a strong inference of scienter. *See, e.g.*, *In re Affiliated Computer Servs. Derivative Litig.*, 540 F. Supp. 2d 695, 702 (N.D. Tex. 2007) (noting that allegations regarding the signatures of the individual defendants on SEC Forms 10-K "are not sufficient, *by themselves*, to establish scienter on behalf of those Defendants"); *Hansen*, 527 F. Supp. 2d at 1159-60 (rejecting plaintiffs' contention that the individual defendants' signatures on various public filings gave rise to a strong inference of scienter).

Nor does the "signing of quarterly certifications of financial statements mandated by the Sarbanes-Oxley Act . . . without more, support an inference of scienter." *Rudolph v. UTStarcom*, 560 F. Supp. 2d 880, 889 (N.D. Cal. 2008). Plaintiff alleges that Messrs. Hutcheson and Khalifa signed Sarbanes-Oxley ("SOX") certifications in connection with various SEC filings throughout the Class Period. *See, e.g.*, Complaint ¶¶ 81-82 (Hutcheson signed SOX certification for SEC Form 10-Q for 2Q06); *id.* ¶¶ 94-95 (Hutcheson and Khalifa signed SOX certification for SEC Form 10-Q for 3Q06); *id.* ¶ 115 (Hutcheson and Khalifa signed SOX certification for 2006 SEC Form 10-K). These signatures were required by SEC rules and regulations governing public company SEC filings.[3] Merely alleging, as Plaintiff does here, that a defendant signed a

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[3] Such certifications are required under Exchange Act Rules 13a-14 and 13a-15, 17 C.F.R. § 240.13a-14, 17 C.F.R. § 240.13a-15.

Sarbanes-Oxley certification – without alleging particularized facts demonstrating that the defendant had knowledge of information that rendered the certification inaccurate at the time it was signed – is insufficient to give rise to a strong inference of scienter. *See, e.g.*, *Morgan v. AXT, Inc.*, No. C 04-4362, 2005 WL 2347125, at *15 (N.D. Cal. Sept. 23, 2005) ("Plaintiff has not alleged particularized facts to support his claim that Defendant['s] averments that he had examined the Company's internal disclosure controls and believed they were adequate, were false."); *Hypercom*, 2006 WL 1836181, at *11 ("[A]n incorrect Sarbanes-Oxley certification does not, by itself, create a strong inference of scienter.").[4] Indeed, "if that were true, 'scienter would be established in every case where there was an accounting error or auditing mistake made by a publicly traded company, thereby eviscerating the pleading requirements for scienter set forth in the PSLRA.'" *Int'l Rectifier*, 2008 U.S. Dist. LEXIS 44872, at *59 (citation omitted).

2. Mere Membership on the Audit Committee Is Insufficient to Give Rise to a Strong Inference of Scienter.

Although Plaintiff collectively names the Audit Committee members – Messrs. Harkey, LaPenta and Targoff – as defendants in the Complaint, Plaintiff makes no attempt to plead particularized allegations regarding each of these individual's alleged misconduct. Indeed, the only specific references to Messrs. Harkey and LaPenta in the Complaint are in the paragraphs listing the parties and in the list of signatories to the 2006 SEC Form 10-K. *See* Complaint ¶¶ 1, 26-28, 111, 114. Just one additional reference is made to Mr. Targoff in the chart of stock sales. *See id.* ¶ 197; *see infra* at 15. Thus, Plaintiff seeks to impose liability on Messrs. Harkey, LaPenta and Targoff based solely on conclusory allegations of collective "Audit Committee" awareness of alleged accounting and internal control issues. *See supra* at 7-8; Complaint ¶ 31. Such allegations, which fail to provide particularized facts detailing *each defendant's* alleged conduct, are patently inadequate to plead scienter under the Reform Act. *See, e.g.*, *Hansen*, 527

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[4] *See also In re Cyberonics, Inc. Sec. Litig.*, 523 F. Supp. 2d 547, 554 (S.D. Tex. 2007) ("As plaintiffs again have failed to link these certifications to the alleged fraud with the particularity required, the allegation that the certifications were false are merely conclusory. It simply is not enough to argue that defendants must have known of the fraud given their positions.").

F. Supp. 2d at 1159 ("It also is insufficient to demonstrate a strong inference of scienter for Plaintiff to allege that various of the Individual Defendants held positions on various committees, such as the executive, audit, and compensation committees.").

Rather, to satisfy the stringent pleading requirements of the Reform Act, Plaintiff must plead particularized facts with respect to *each Audit Committee member* – separate and apart from generalized allegations directed at the collective body – that give rise to a strong inference of culpable conduct on the part of *each defendant*. 15 U.S.C. § 78u-4(b)(2); *see also VeriSign*, 531 F. Supp. 2d at 1206-07 (holding that conclusory allegations regarding committee memberships and knowledge of false financial statements failed to "satisfy the pleading requirements of the PSLRA because plaintiffs neither specify the roles that [the former CFO] and each of the director defendants played . . . in the alleged scheme to issue false financial reports, nor allege facts giving rise to a strong inference of scienter as to *each* defendant"). Plaintiff fails, however, to plead any facts regarding what Messrs. Harkey, LaPenta and Targoff allegedly did or did not know regarding the accounting and internal control matters at issue, when each person allegedly became aware of issues or how he allegedly knew it. Plaintiff's conclusory allegations regarding the Audit Committee Defendants are thus insufficient to give rise to a strong inference of scienter. *See Hansen*, 527 F. Supp. 2d at 1159 ("Plaintiff has failed to allege any specifics with respect to the Individual Defendants' knowledge or an adequate description of their activities on various committees.").

C. Plaintiff's Stock Sale Allegations Fail to Provide the Missing Inference of Scienter

Unable to plead facts demonstrating that any of the Individual Defendants intentionally or recklessly disseminated false statements, Plaintiff attempts to bolster the Complaint's deficient scienter allegations with allegations of insider stock sales. *See* Complaint ¶ 197. Mere allegations of stock sales by an officer or director, however, do not equate to securities fraud. *See VeriSign*, 531 F. Supp. 2d at 1207 ("The Ninth Circuit has noted that insiders often sell stock for a variety of reasons having nothing to do with fraud, and has concluded that even large stock sales, without more, cannot give rise to a strong inference of scienter.") (citations omitted).

Rather, Plaintiff has "'the burden at the pleading stage of explaining why the stock sales were unusual or suspicious'"; that is, Plaintiff "must show the trading was in amounts 'dramatically out of line with prior trading practices, *at times calculated to maximize the personal benefit from undisclosed inside information.*'" *Alaska Elec. Pension Fund*, 434 F. Supp. at 833 (citations omitted). Plaintiff pleads no such facts.

In evaluating whether stock sale allegations support a strong inference of scienter, courts consider a number of factors, including: "(1) the amount and percentage of the shares sold; (2) the timing of the sales; and (3) whether the sales were consistent with the insider's prior trading history." *Metzler*, 2008 WL 3905427, at *13. An analysis of these factors reveals that Plaintiff's conclusory – and contextually unsupported – stock sale allegations fail to provide the requisite strong inference of scienter. Moreover, any inference of scienter is completely undermined by the fact that Plaintiff's Complaint is devoid of any allegations demonstrating that the stock sales were based on material non-public information.

1. The Stock Sales by the Individual Defendants Were Neither Unusual Nor Suspicious.

a. Neither Mr. Harkey Nor Mr. LaPenta Sold Any Shares of Leap Stock During the Class Period.

Plaintiff does not allege that either Mr. Harkey or Mr. LaPenta sold a single share of Leap stock during the Class Period. Complaint ¶ 197.[5] The absence of any sales by these Individual Defendants directly contradicts Plaintiff's contention that the Individual Defendants were motivated to commit securities fraud because they sought to profit from insider stock sales. *See Metzler*, 2008 WL 3905427, at *13 (noting that, although certain defendants had sold shares of stock during the class period, the president of the defendant corporation sold "nothing at all, suggesting that there was no insider information from which to benefit"); *Ronconi v. Larkin*, 253 F.3d 423, 436 (9th Cir. 2001) ("One insider's . . . sales do not support the 'strong inference' required by the statute where the rest of the equally knowledgeable insiders act in a way inconsistent with the inference that the favorable characterizations of the company's affairs were

[5] Mr. Khalifa, who did not have any vested options available to sell during the Class Period, also did not sell any Leap stock during the Class Period.

known to be false when made.") (footnotes omitted); *McGuire v. Dendreon Corp.*, No. 07-800, 2008 WL 1791381, at *9 (W.D. Wash. Apr. 18, 2008) ("[T]he fact that three other Individual Defendants did *not* sell their shares undermines Plaintiffs' scienter argument.") (citation omitted); *Alaska Elec. Pension Fund*, 434 F. Supp. 2d at 834-35 (same).[6] Moreover, it simply makes no sense that six officers and directors – together with the outside independent auditors – would engage in a scheme to defraud investors for the benefit of just three individuals.

b. The Stock Sales by Messrs. Hutcheson, Burton and Targoff Were Neither Unusual Nor Suspicious.

i. S. Douglas Hutcheson

Plaintiff alleges that Mr. Hutcheson sold 6,902 shares of Leap stock on February 27, 2007 and 17,021 shares of Leap stock on May 23, 2007. Complaint ¶ 197. Without providing any supporting details, Plaintiff alleges that the number of shares sold by Mr. Hutcheson during the Class Period was "more than double the number of shares he sold in the year preceding the commencement of the Class Period." *Id.* ¶ 22.

Although technically accurate, Plaintiff's selective use of the number of shares sold fails to provide the requisite context for the sales, including the percentage of available holdings sold. *See Ronconi*, 253 F.3d at 436-37 (plaintiffs "must allege sufficient context of insider trading"). A review of publicly available information reveals that Mr. Hutcheson sold just 34% of his available holdings during the Class Period.[7] That percentage is, in fact, lower than the percentage of stock sold by Mr. Hutcheson (38%) in the comparable period prior to the Class Period.[8] Thus, Mr. Hutcheson's Class Period stock sales were consistent with – and not dramatically out of line with – his prior trading history. *See, e.g., Vantive*, 283 F.3d at 1095 (defendant's sale of 32% of holdings not suspicious where "sales during the class period were not 'dramatically out of line' with . . . prior trading practices"); *see also Indiana Elec. Workers' Pension Trust Fund IBEW v. Shaw Group, Inc.*, – F.3d – , 2008 WL 2894793, at *12 (5th Cir. July 29, 2008) (finding that defendant CFO's sale of 57% of holdings was not out of line with past actions where CFO sold approximately 65% of his holdings in the prior year).

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[6] *See also In re Alpharma Inc. Sec. Litig.*, 372 F.3d 137, 152 (3d Cir. 2004) (finding that plaintiffs failed to plead facts giving rise to a strong inference of scienter where a key insider sold no shares during the class period and plaintiffs failed to plead facts demonstrating that the sales of the remaining defendants were unusual in scope or timing); *Acito v. IMCERA Group, Inc.*, 47 F.3d 47, 54 (2d Cir. 1995) ("The fact that the other defendants did not sell their shares during the relevant class period undermines plaintiffs' claim.").

[7] The percentage of shares sold was determined by dividing the total number of shares sold during the Class Period by the total number of shares that had vested and/or were available for sale. During the Class Period, Mr. Hutcheson had approximately 71,000 shares available for sale. *See* Walters Decl., Ex. B at 10-11 (reflecting 70,934 vested shares) & Ex. C at 24 (reflecting purchase of 98 shares through Leap's Employee Stock Purchase program in June 2007). Plaintiff alleges that Mr. Hutcheson sold 23,923 shares during the Class Period. *See* Complaint ¶ 197; Walters Decl., Ex. C at 20-23 (reflecting sales on February 27, 2007 and May 23, 2007). Thus, the total number of shares sold (23,923) divided by the total number of sales available (approximately 71,000) equals 34%.

The timing of Mr. Hutcheson's Class Period stock sales also fails to support an inference of scienter. Both of the alleged stock sales occurred long before the alleged "fraud" was revealed in November 2007, thus negating a strong inference of scienter. *See Grillo v. Tempur-Pedic Int'l, Inc.*, 553 F. Supp. 2d 809, 822 (E.D. Ky. 2008) ("The longer the time between stock sales and the disclosure of bad news, the more scienter is negated."); *In re Read-Rite Corp. Sec. Litig.*, 115 F. Supp. 2d 1181, 1183 (N.D. Cal. 2000) (stock sales "occurring many months prior to the announcement which triggered the stock price correction upon which this action pivots, do not amount to a strong implication of the requisite scienter"), *aff'd*, 335 F.3d 843 (9th Cir. 2003). Moreover, both sales took place after the announcement of financial results during a window in which corporate officers typically trade. *See Lipton v. PathoGenesis Corp.*, 284 F.3d 1027, 1036-37 (9th Cir. 2002) (timing not suspicious where insider sold stock following positive announcement of year-end results); *see also City of Austin Police Ret. Sys. v. ITT Educ. Servs., Inc.*, 388 F. Supp. 2d 932, 951 (S.D. Ind. 2005) ("The fact that sales occurred after earnings announcements means nothing. Corporate insiders typically are barred from trading for a period of time before such announcements precisely to avoid charges of insider trading, so sales are often made after such announcements.").

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[8] The purported Class Period runs from August 3, 2006 to November 9, 2007, a period of 464 days. The comparable time period preceding the Class Period would be April 26, 2005 to August 2, 2006. During this time, Mr. Hutcheson had approximately 30,326 shares available for sale (*see* Walters Decl., Ex. C at 13, 17-18), and he sold 11,623 shares (*see id.* at 15), or approximately 38%.

ii. Grant Burton

Plaintiff alleges that Mr. Burton sold 665 shares of Leap common stock on February 27, 2007, and that prior to the Class Period, Mr. Burton had not sold a single share of Leap common stock. Complaint ¶ 23. As an initial matter, Plaintiff's barebones allegations fail to provide any information regarding Mr. Burton's available holdings (*see id.*), the percentage sold, or any other information that would put Mr. Burton's sale in context. *See supra* at 13. Moreover, Plaintiff has not pled – and cannot plead – any facts to suggest that the timing or amount of Mr. Burton's sale was unusual or suspicious. *First*, the size of the sale – 665 shares – is negligible. One small stock sale is insufficient to establish a "pattern" or "trading history" for purposes of comparison. *Second*, as with Mr. Hutcheson's stock sales, the sale was made following an earnings release and was made long before the alleged "fraud" was revealed. *See supra* at 14; *see also Int'l Rectifier*, 2008 U.S. Dist. LEXIS 44872, at *63-64 (timing of stock sales not suspicious where sales took place shortly after earnings releases and well over a year before announcement of accounting errors). Thus, Mr. Burton's single stock sale during the Class Period is neither unusual nor suspicious.

iii. Michael Targoff

Plaintiff alleges that Mr. Targoff sold 35,000 shares of Leap stock, or 90.97% of his available holdings, on June 6, 2007, and that prior to the Class Period, Mr. Targoff had not sold a single share of Leap common stock. Complaint ¶ 26. As with the stock sales by Messrs. Hutcheson and Burton, Mr. Targoff's stock sale fails to support a strong inference of scienter as it was made during a period following an earnings announcement, and it occurred many months before the alleged "fraud" was revealed. *See supra* at 14. Moreover, as demonstrated *supra* at 7-11, Plaintiff fails to plead any particularized facts to suggest that Mr. Targoff was aware of any accounting or internal control issues at the time of the sale. *See also* Leap Motion to Dismiss at 15-25.

2. The Alleged Stock Sales by Non-Defendants Are Irrelevant.

Notably, the overwhelming majority of sales alleged in the Complaint were made by individuals or entities ***who are not named as Defendants in this action***. In the "Additional

Scienter Allegations" section of the Complaint, Plaintiff includes stock sales allegedly made by two *non*-defendants, Chief Technical Officer Glenn Umetsu and former outside director James Dondero. *See* Complaint ¶ 197. The alleged stock sales by these non-defendants account for approximately ***92%*** of the stock sales included in the Complaint. Plaintiff's attempt to obscure the weak nature of the stock sale allegations by including these additional sales is unavailing; sales by non-defendants are irrelevant. *See Tripp v. Indymac Fin. Inc.*, No. CV07-1635, 2007 WL 4591930, at *4 n.1 (C.D. Cal. Nov. 29, 2007) ("Any sales by a non-defendant are irrelevant."); *Plevy v. Haggerty*, 38 F. Supp. 2d 816, 834 n.12 (C.D. Cal. 1998) (sales of non-defendants held "irrelevant" to scienter of the named defendants); *cf. McGuire*, 2008 WL 1791381, at *9 n.2 (stock sales of individuals who had been dismissed were irrelevant to scienter analysis on motion to dismiss).

Indeed, Plaintiff barely references Messrs. Umetsu or Dondero in the Complaint, much less alleges that they intended to assist defendants in any alleged insider trading scheme. The Complaint only mentions Mr. Umetsu once, in passing, before listing his alleged stock sales. *See* Complaint ¶ 62 (alleging that "Daily Minute Reports" were provided to "Senior Executives," including Mr. Umetsu). Moreover, the only reference to Mr. Dondero in the Complaint is the inclusion of his name in the heading above the list of his alleged stock sales. *See id.* ¶ 197. In the absence of any allegations that Messrs. Umetsu or Dondero intended to assist the Individual Defendants in any alleged wrongdoing, their alleged stock sales are irrelevant and should be disregarded.[9]

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[9] Even if the Court were to consider the alleged stock sales by non-defendants Umetsu and Dondero, Plaintiff fails to plead facts demonstrating that the sales are probative of scienter. Plaintiff does not allege any information about past trading practices or other information to suggest that these transactions were unusual or suspicious. *See supra* at 11-12. Indeed, although Plaintiff includes a list of stock sales under the heading "Dondero's Class Period Stock Sales," these sales were not Mr. Dondero's personal transactions, but rather, were made by various investment funds with which Mr. Dondero is affiliated. *See* Walters Decl., Ex. D at 25-34. Regardless, there is nothing unusual or suspicious about the percentage of shares sold, which represented approximately 14% of the total shares available for sale. *See* Walters Decl., Exs. D at 25-34 & B at 10 (During the Class Period, the funds sold 633,000 shares; those same entities had 4,685,081 shares available for sale.). Similarly, Plaintiff does not provide any contextual details to demonstrate that the trades by Mr. Umetsu were unusual or suspicious. To the contrary, Plaintiff's own allegations reflect that Mr. Umetsu regularly sold shares on a monthly basis. *See* Complaint ¶ 197; Walters Decl., Ex. E. Finally, Plaintiff's allegations appear to

(continued...)

In sum, when the alleged stock sales in the Complaint are "viewed as a whole," they fail to give rise to a strong inference of scienter. *Metzler*, 2008 WL 3905427, at *13.

D. Plaintiff's Generic Compensation Allegations Are Insufficient to Give Rise to a Strong Inference of Scienter

Plaintiff's assertion that the Management Defendants "were also substantially motivated to issue materially false and misleading statements in order to increase [their] bonus and stock option compensation" (Complaint ¶ 198) also fails to "bolster" Plaintiff's allegations. *Constr. Laborers Pension Trust v. Neurocrine Bioscis., Inc.*, No. 07cv1111, 2008 WL 2053733, at *7 (S.D. Cal. May 13, 2008) (rejecting plaintiffs' attempt to "bolster" their scienter allegations with allegations of "receipt of bonus compensation" and noting that the Ninth Circuit "has explained" that "'routine business objectives, without more, cannot normally be alleged to be motivations for fraud'") (citing *Lipton*, 284 F.3d at 1038). Conclusory allegations regarding incentive compensation, such as those asserted here, are insufficient to give rise to a strong inference of scienter. *See, e.g., Indiana Elec. Workers Pension Trust Fund IBEW*, 2008 WL 2894793, at *13 ("[I]ncentive compensation 'can hardly be the basis on which an allegation of fraud is predicated.'") (citation omitted); *Int'l Rectifier*, 2008 U.S. Dist. LEXIS 44872, at *64 ("[S]uch bonuses have little probative value as to scienter."); *In re Tibco Software, Inc. Sec. Litig.*, No. C 05-2146, 2006 WL 1469654, at *21 (N.D. Cal. May 25, 2006) (holding that allegations concerning incentive compensation are insufficient to plead scienter); *In re Autodesk, Inc. Sec. Litig.*, 132 F. Supp. 2d 833, 843-44 (N.D. Cal. 2000) (allegations that the individual defendants were motivated to engage in fraud by the prospect of receiving large bonuses rejected as a means of alleging scienter). Such allegations are particularly deficient where, as here, the restatement had the effect of understating revenue for certain periods and increasing it in others. *See* Leap Motion to Dismiss at 2, 7, 8, 16 & 24.

(...continued from previous page)
overstate Mr. Umetsu's trades – by over $1 million – by counting the same trades twice on February 27, 2007 and February 28, 2007 (apparently due to duplicative SEC Form 4 filings). *See* Complaint ¶ 197.

E. Plaintiff's Own Allegations Negate an Inference of Scienter

As Plaintiff's allegations in the Complaint acknowledge, the Company publicly disclosed the accounting errors after conducting an internal review. Complaint ¶ 139. The November 9, 2007 press release explained that the "restatements [were] the result of an internal review of the Company's service revenue activity and forecasting process that was initiated by management in September 2007." *Id.* (emphasis omitted). Management's decision to conduct such a review contradicts any suggestion that the defendants sought to conceal the financial statement errors. *See, e.g., Higginbotham v. Baxter Int'l, Inc.*, 495 F.3d 753, 758 (7th Cir. 2007) (noting that the Company's decision to conduct an investigation over the course of two months "demonstrat[ed] a pursuit of truth rather than reckless indifference to the truth").

Moreover, the November 9, 2007 press release further disclosed that the restatements were "not attributable to any misconduct by Company employees." Complaint ¶ 139; *see also id.* ¶ 147 ("The errors were neither intentional nor the result of employee misconduct, and the Company worked closely together with the audit committee and our independent auditors to correct errors."). In the face of these publicly disclosed findings – which give rise to compelling and competing inferences of non-culpable conduct – Plaintiff's factually unsupported theories of securities fraud fail under *Tellabs*. 127 S. Ct. at 2510 ("[T]he inference of scienter must be *more* than merely 'reasonable' or 'permissible' – it must be cogent and compelling, thus strong in light of other explanations."); *cf. In re CNET Networks, Inc. S'holder Derivative Litig.*, 483 F. Supp. 2d 947, 963 (N.D. Cal. 2007) ("Plaintiffs would also have the Court ignore that the special committee concluded that there was no wrongdoing by any current or recently resigned directors or officers. In view of this statement, the inference that fraud still occurred despite an investigation and the eventual public release of results is improper absent other facts indicating fraud.").

* * *

In sum, because Plaintiff fails to plead particularized facts giving rise to a strong inference that any of the Individual Defendants acted with scienter, Plaintiff's Section 10(b) claim should be dismissed as to each of the Individual Defendants.

II. PLAINTIFF'S SECTION 20(a) CLAIM SHOULD BE DISMISSED

Because the Complaint does not adequately allege an actionable claim under the Exchange Act against any of the Individual Defendants, the Section 20(a) claim for control person liability must also be dismissed. *See, e.g.*, *Lipton*, 284 F.3d at 1035 n.15.

CONCLUSION

For the foregoing reasons, the Individual Defendants respectfully request that Plaintiff's Complaint be dismissed in its entirety.

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